No. 22096

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRIETTA M. FAUCHER, aka H. M. FAUCHER,

Appellant,

vs.

DOLORES KNOLL LOPEZ, LOUISE M. GIOVANNONI, and JOSEPH E. HAZEL,

Appellees.

APPELLEES' BRIEF.

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Appellees.

APPELLEES' BRIEF.

Statement of the Case.

Appellees, do not believe appellant's statement of the case is adequate or accurate and sets forth their own statement.

On May 13, 1963 Appellees filed an involuntary petition in bankruptcy against the alleged bankrupt. On August 23, 1963 H. M. Faucher filed an answer, affirmative defenses and counterclaim and a demand for a jury trial. Among other things, the alleged bankrupt denied she was insolvent at the time the alleged acts of bankruptcy occurred.

Therefore, pursuant to Section 3(d) of the Bankruptcy Act, (11 U.S.C. Sec. 21(d)) the Referee in bankruptcy, Joseph J. Rifkind, ordered her to appear before him, with all of her books, papers, and accounts and to submit to an examination and give testimony

on the issue of solvency or insolvency. This hearing took place before the Referee on August 16 and 23, 1963, and at that time the alleged bankrupt invoked the privilege of the Fifth Amendment of the Constitution of the United States and refused to testify. [See Ex. 29, S. M. Tr. p. 439, S. M. Report, R. 362, lines 19-29.]

Subsequently, Irving I. Bass, the Bankruptcy Court Receiver, on November 26, 1963 filed a motion before the Honorable Pierson Hall for an order requiring the alleged bankrupt to turn over all of her books, records and documents to him as custodian of her property. The alleged bankrupt again resisted upon the grounds that her books, records and documents, contained information which might tend to incriminate her and were thus privileged under the Fourth and Fifth Amendments to the Constitution of the United States. Judge Hall denied the motion Irving I. Bass upon the grounds the books and records were privileged. [R. pp. 355-356, lines 13-32, lines 1-3.]

On December 12, 1963, Appellees then filed Request for Interrogatories seeking information concerning appellant's financial condition and to locate the whereabouts of her books and records. [R. 232.] Again, the bankrupt resisted answering the interrogatories upon the grounds the information was privileged as self-incriminating. [R. 234.] On December 23, 1963, the Appellees filed a motion for an early trial date, under Section 18(d) of the Federal Bankruptcy Act (11 (U.S.C. Sec. 41(d)). [R. 243.] On March 3, 1964 Appellees served further interrogatories upon the appellant and received further objections upon the same grounds of privilege. On April 7, 1964 appellees

filed a motion for judgment on the pleadings and to enter the bankrupt's default. All of the matters were heard April 20, 1964 and Judge Yankwich, then the Judge assigned to the case, ordered the Appellant to answer the interrogatories within 10 days and continued the hearing. Since a trial date was approaching, Appellees further filed, on June 12, 1964, Request for Admissions, which the Appellant refused to answer on the usual grounds of privilege against self-incrimination. Appellant, on June 18, 1964 filed a motion for a Protective Order, which was heard by Judge Yankwich on June 22, 1964.

Judge Yankwich granted the Appellant's motion and set the matter for trial on June 23, 1964. On June 23, 1964 the morning of the jury trial, Judge Yankwich, upon the motion of Appellant granted an indefinite continuance to Appellant, over the vigorous objections of Appellees. On motion of Appellees the matter was then transferred to Judge Albert Lee Stephens, Jr. On July 15, 1964, Appellees filed a Motion for Sanctions under FRCP 37, and another motion for an early trial date before Judge Stephens.

These motions were all taken under submission by Judge Stephens and later on September 11, 1964, all were denied.

On November 13, 1964, Appellees moved for the appointment of a Special Master, on both the non-jury and jury issues of the case. At that time Judge Stephens denied the motion for a Special Master but set the matter for pre-trial hearing. On February 8, 1965, the Appellees filed their Memorandum of Contentions pursuant to Local Rule 9. [R. 270.] At the hearing on the pre-trial Judge Stephens reconsidered

his earlier ruling, and referred to non-jury issues to Referee Rifkind as Special Master. This ruling was incorporated in his Pre-Trial Order date April 7, 1966.

Prior to the hearing before Referee Rifkind and on April 26, 1966, as Special Master, Appellees served a Notice To Produce upon Appellants, but no books, records, ledgers or any other documents were produced at the hearing. [R. p. 300.] On August 12, 1966, the Special Master after three days of testimony and argument commencing May 23, 1967, filed his report, together with his findings of fact and conclusions of law on the non-jury issues. [R. 350-358.]

Appellant filed objections to the Special Master's report with Judge Stephens on August 18, 1966. [R. p. 361.] However no transcript of the testimony of the hearing was supplied to Judge Stephens, and these objections were overruled and the report was approved with one modification. [R. 387-388.] The matter was then set for trial of the jury issues in January, 1967, but continued until May 2, 1967. After hearing the evidence, and the arguments Judge Stephens entered a directed verdict for Appellees. This directed verdict affirmed the Special Master's Report and adjudicated Appellant a bankrupt. [R. 396-399.]

The Appellant then filed a motion for a new trial on May 12, 1967, which was opposed by Appellees and denied by the court.

Alleged Specification of Errors.

I.

Appellant cites no authorities for her contention that certain errors occurred in referring the non-jury issue to a special Master, and in the proceedings before the

Special Master and the District Court Judge. Nevertheless, Appellees will respond to the specifications by referring to the record before the court.

REFERENCE TO SPECIAL MASTER WAS PROPER.

This appellate court should note that in a trial upon an involuntary petition in bankruptcy, the alleged bankrupt is entitled to a jury trial *only* upon the issue of insolvency, pursuant to Section 19(a) of the Bankruptcy Act. (11 U.S.C. 42a.)

> *In re Airmont Knitting and Undergarment Co.,* 182 F. 2d 740 (2 C.A. 1950);
>
> Moore's Federal Practice, Vol. 5, Sec. 38.30 [2] pp. 215-217.

In the event no jury trial is demanded then the hearing on the adjudication is normally held before the Referee in Bankruptcy, pursuant to the usual order of reference from the Judges of the U.S. District Court.

> Moore's Federal Practice, Vol. 5, Sec. 53.12 [6] pp. 2990-2993.

The reference of the nonjury aspects of the cause to a special Master was proper. On November 13, 1964, the Appellees filed a Notice of Motion and Application for Appointment of Special Master with Judge Stephens. He initially denied the application, but after it became clear the matters to be litigated were enormously complicated, and involved matters of Account as defined in Federal Rules of Civil Procedure 53(b). Judge Stephens reconsidered his earlier ruling and in his Pre-Trial Conference Order of April 7, 1966, referred the non-jury issues to Joseph J. Rifkind as Special Master pursuant to Rule 53(e)(2) of the Federal Rules of Civil Procedure. [R. 35, lines 22-25.]

It is evident from the Memorandum of Contentions of Fact and Law of Petitioning Creditors Pursuant to Local Rule 9 [R. 270-287] just how complicated and exceptional the issues were.

It should be pointed out Appellant never urged any reasons for her objection to the reference to the Special Master. The usual reason of additional expense was not valid, since the Special Master appointed was a Referee in Bankruptcy whose court and Reporter were readily available at no extra cost.

The reviewing court should remember that neither the Judge nor Appellees were sure whether or not the missing books would suddenly appear at the trial to refute the creditors' figures. A hearing before a Special Master was a far more flexible forum for such an unexpected event and would not necessarily result in a postponement or mistrial. Finally there appears to be a more liberal policy in referring bankruptcy matters to Special Masters, than in other types of cases.

In re Joslyn's Estate, 171 F. 2d 159, 164 (7 C.A. 1948);

Moore's Federal Practice, Vol. 5, Sec. 53.05[2] p. 2939.

Appellant Has No Constitutional Right to Attend Civil Trial.

Appellant has repeatedly contended that it was incumbent upon either the Referee, the Special Master, the District Judge and/or the United States Marshal to secure the presence of the Appellant at the trial and the hearing and that the failure of these parties and/or all of them to do so, somehow contributed to a denial of due process.

In Point II, Appellant refers to this "Exclusion" from the trial. Inasmuch as the authorities contained in Appellant's Point II relate to the specification in error in Sub. (b), Appellee will deal with them here.

The Special Master deals with Appellant's assertion that she should have been present at the hearing, starting on line 7, page 3 through line 21, page 5 of his report. [R. 352-354.]

Judge Stephens offered to hold trial at the prison if counsel for Appellant could give some assurance that some useful purpose could be accomplished as described in Findings of Fact II by Judge Stephens. [R. 379, lines 7-28.]

The Appellant contends that there was a "violation of the Order of Writ of Habeas Corpus Ad Testificandum", because she was not delivered to the courtroom. From this alleged "violation" she asks the court to draw another inference to the effect that she was deprived of a "right to be present at the trial". No right of Mrs. Faucher was violated since no such right exists.

The alleged bankrupt is confusing this involuntary bankruptcy proceeding with a criminal prosecution, in which the defendant would have certain rights guaranteed by the Sixth Amendment of the Constitution of the United States.

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witness

against him; to have compulsory process for obtaining Witnesses in his favor, and to have the Assistance of Counsel for his defense.

However, even these Constitutional guarantees have their limits. The Supreme Court of the United States has held that where the guilt of the defendant is in issue, as in a criminal trial, his presence is required by the Sixth Amendment, but that mere existence of the power to produce a prisoner in a *habeas corpus* proceeding does not mean that the prisoner should be automatically produced in every such proceeding.

United States v. Hayman, 342 U.S. 205, 72 S. Ct. 263, 96 L. Ed. 232 (1952).

A Writ of Habeas Corpus Ad Testificandum is a discretionary writ.

Title 28, U.S.C., Sec. 2241;

Gilmore v. U.S., 129 F. 2d 199 (10 C.A. 1942), Cert. den. 317 U.S. 631, 63 S. Ct. 55, 87 L. Ed. 509;

Cukovich v. U.S., 170 F. 2d 89 (6 C.A. 1948), Cert. den. 336 U.S. 905, 69 S. Ct. 484, 93 L. Ed. 1070.

Since the alleged bankrupt has no absolute right to even the issuance of such a writ, she certainly has no absolute right to be present by the issuance of said writ. The courts in an analogous situation have declined to issue a requested Writ of Habeas Corpus Ad Testificandum requiring the appearance of a witness incarcerated in a state prison where it ascertained the witness would claim the Fifth Amendment.

Murdock v. U.S., 283 F. 2d 585 (10 C.A. 1960), cert. den. 366 U.S. 953, 81 S. Ct. 1910, 6 L. Ed. 2d 1246.

The Appellant has not been deprived of any right to be heard. She has at all times been represented by counsel and has had innumerable opportunities to testify either by deposition or otherwise during the four years the case was pending.

If Appellant's argument was correct and a person was guaranteed the absolute right to be present at a civil trial in which she was a defendant, then no plaintiff could ever obtain a default judgment against an absent defendant. This clearly is not the law.

II.

The Findings of the Special Master are all amply supported by the record:

Finding No. 1—R. 357-358

> It is clear that Mrs. Faucher sold fictitious notes, trust deeds and title insurance policies to the petitioning creditors, for which they paid valuable consideration.
>
> Mrs. Daniel Lopez—S.M. Tr. p. 20, lines 9-26, Ex. 1; pp. 21-23, Ex. 2; pp. 25-26; Exs. 3 and 4; pp. 27-31, p. 133, Exs. 5 and 6; pp. 69-71; Exs. 1-2; pp. 81-85, p. 91, lines 14-26.
>
> Mr. and Mrs. Giovannoni—S.M. Tr. pp. 95-99, Ex. 7; pp. 100-101, Ex. 8; pp. 101-102, Ex. 9; pp. 102-107, Ex. 10; pp. 107-108, Ex. 11; pp. 108-109, Ex. 12; pp. 109-113, Ex. 13; pp. 113-120, Ex. 14; pp. 121-131, Ex. 15; pp. 138-139, p. 150, lines 19-23, pp. 176-180, Ex. 16; pp. 180-190; pp. 216-218.
>
> Mr. and Miss Hazel—S.M. Tr. pp. 222-225, Ex. 17; pp. 226-231, Exs. 18 and 19; pp. 231-232, Ex. 20; pp. 234-235; pp. 236-239, Ex. 21; pp. 240-260; pp. 282-294.

Finding No. 2—R. 358

The obligations are unsecured and are debts of the alleged bankrupt—S.M. Tr. pp. 307-330.

Finding No. 4—R. 358

The legal basis of this finding is discussed in detail in Points I, II, III and IV of this brief. Reference is made therein to Exhibits No. 2, 13 and 14.

Finding No. 5—R. 358

The legal basis of this finding is discussed in detail in Point IV of this brief. The evidence supporting this finding is found in S.M. Tr. pp. 20-379, Ex. 1-26.

Finding No. 6—R. 358

The legal basis of this finding is discussed in detail in Points V and VI of this brief. The factual basis is Exhibit 29.

Finding No. 7—R. 358

The legal basis for this finding is discussed in detail in Point I, II and III of this brief. The Exhibits clearly show only Exhibits 2, 13 and 14 could be construed as usurious. The testimony shows no amounts in excess of 10% of the principal were ever received by the petitioning creditors within any one year. S.M. Tr. pp. 21-26, pp. 108-131.

III.

(a) No error in law occurred in the trial before the District Court prejudicial to the alleged bankrupt. If any error occurred it was in her favor. Point V of this brief, together with Exhibit 29, clearly demonstrates that the burden of proof upon the issue of insolvency shifted to the alleged bankrupt on August 16,

1963. On that day she appeared before Referee in Bankruptcy, Joseph J. Rifkind, pursuant to Section 3 (d) of the Bankruptcy Act (11 U.S.C. Sec. 21d) and admitted having books and records relating to her business, but failed to produce them for examination, and refused to disclose their whereabouts.

The District Court actually allowed her additional time to produce them by giving her until the trial on May 2, 1967. Her civil disability on that date was no excuse, since she was not imprisoned on August 16 and 23, 1963, when she should have produced them.

(b) A directed verdict was proper under the circumstances of the trial. This is discussed in detail in Point VI of this brief and is fully supported by the testimony presented at the trial. [D.C. Tr. pp. 4-179.]

POINT I.

Appellees' Claims Against Appellant Are Not in Violation of the California Usury Laws.

The majority of the instruments are not usurious, even when the amount of the discount or bonus is added to the interest provisions. Only the promissory notes contained in Exhibit "2" payable to Mrs. Lopez, and the two Promissory notes in Exhibits "13" and "14" payable to the Giovannoni's provide for a 10% interest rate. All the remaining notes provide for either a 7% or a 7.2% interest rate. If the amount of discount is prorated over the term of the 7% and 7.2% notes, the interest rate received upon the sums actually paid by the creditors does not exceed 10%.

That is, 10% of the amounts actually paid for the notes (*e.g.* 10% of $3,000.00 in Exhibit "19" equals

$300.00), is still greater than 7% of the face amount of the note, which includes the discount (*e.g.* 7% of $3,333.33 equal $233.33). Thus, only Exhibits "2", "13", and "14" can be construed as usurious, if the court looks behind the face of the notes.

However, in each of the 10% notes, the payments made were all credited to interest only, and no amounts were ever credited to principal. Thus, the entire defense of usury boils down to the legal effect of those three promissory notes. And since the last payments were not made on those notes, the amount of interest paid up until the date of the institution of these proceedings, even on the 10% notes, did not exceed the maximum rate available for the term of the note.

POINT II.

Usury Is Not a Defense Available to Mrs. Faucher.

1. Appellees' claims against Mrs. Faucher are based upon rescission of the contracts of sale of the notes and trust deeds to them by Mr. Faucher. The Appellees are not seeking to enforce any of the usurious notes against any of the ostensible payees thereon. On the contrary, Appellees want their money back, since Mrs. Faucher did not deliver what they bargained for. Thus, the issue of usury does not arise, because the Appellees simply have credited all amounts received against the principal amount actually advanced by them for the notes.

Gregg v. Phillips, 105 Cal. App. 132, 286 Pac. 1071 (1930).

Nor did the petitioning creditors receive any greater sums of money from Mrs. Faucher than allowed by law. The Pre-Trial Order expressly finds that the creditors have claims above the purisdictional amount. The Ap-

pellant cannot claim offsets or treble damages sufficiently large to discharge her obligations entirely.

2. If the notes are usurious and are tainted with illegality then this is another ground to rescind the transaction, pursuant to California Civil Code Section 1689, under either mistake of law, or failure of consideration. Mrs. Faucher sold the instruments to Appellees as good, valid, and legally enforcible notes. If they are not, because they violate the law, then she should return the creditors' money.

3. Mrs. Faucher is not a party to the instruments, and thus the defense of usury is not available to her (with the exception of Exhibit 16). Only a party to an instrument can raise the defense of usury since it is personal to the borrower.

Zimmerman v. Boyd, 97 Cal. App. 406, 275 Pac. 507 (1929).

Since Mrs. Faucher received money for notes upon which she did not choose to bind herself, she cannot now take advantage of defenses available to her only if she had so obligated herself.

POINT III.

The Appellees Do Not Have Unclean Hands.

The record of this case clearly demonstrated beyond the slightest doubt that Mrs. Faucher was for many years engaged in the business of selling fictitious promissory notes and forged deeds of trust and title insurance policies to the Appellees. [R. 356, lines 6-31.]

The Appellant's major defense seems to be that since the Appellees were duped into participating in these transactions, and gulled into buying forged and fic-

titious instruments which might be construed as usurious, that therefore they are barred from any equitable relief. The absurd contention finds no support in the law.

Appellant has not cited one case, which holds that a lendor under a usurious agreement was deemed to have unclean hands. The authorities are all to the contrary. California law is not so severe as to declare any usurious contract totally void, thus depriving the lendor ever of the right to collect the principal.

> *Haines v. Commercial Mortgage Co.,* 200 Cal. 609, 254 Pac. 956, 255 Pac. 805, 53 A.L.R. 725 (1927).

California law simply invalidates totally the interest provision of the usurious agreement.

> *Moore v. Russell,* 114 Cal. App. 634, 300 Pac. 479 (1931);
> 49 Cal. Jur. 2d, *Usury,* Sec. 12, p. 675.

If Appellant was correct, then every usurious contract would be automatically void and unenforceable, *in toto,* since every lender would be barred from collecting upon the principal of the note. This clearly is not the law. Indeed, any lendor may simply obviate the defense of usury, by waiving his right to anything other than what is due him on the principal.

> *Gregg v. Phillips,* 105 Cal. App. 132, 286 Pac. 1071 (1930).

This is in effect what Appellees have done by seeking to rescind their contracts with Appellant.

POINT IV.

Appellant Is Estopped to Claim Appellees Have Unclean Hands.

The record is devoid of any evidence that Appellees were ever aware that the promissory notes provided for a usurious rate of interest. Since the record also clearly demonstrates that she falsely and fraudulently, sold the notes to Appellees, she should be estopped from raising the defense of usury.

Stock v. Meek, 35 Cal. 2d 809, 221 P. 2d 15 (1950);

Martin v. Ajax Construction Co., 124 Cal. App. 2d 425, 269 P. 2d 132 (1950);

Paillet v. Vroman, 52 Cal. App. 2d 297 (1942);

Ryan v. Motor Credit Co., 130 N.J. Eq. 531, 23 A. 2d 607, 611 (1941), 132 N.J. Eq. 398, 28 A. 2d 181, 142 A.L.R. 640 (1942).

The *Ryan* case is on all fours with the case at hand and was cited, with approval in the *Stock* case. In *Ryan* the borrower duped the lender into making nearly 500 small loans, using the names of fictitious nominees. The court held that the fiction or presumption that a borrower under a usurious contract is not *in pari delicto* with the lender, could not stand up against the overwhelming facts of that case, and held the borrower estopped to assert a claim of usury.

POINT V.

The Burden of Proof Upon the Issue of Insolvency Was Upon the Appellant.

The Bankruptcy Act provides that when insolvency is in issue, the petitioning creditors, shall be assisted in carrying this burden of proof by requiring the debtor to "appear in Court on the hearing and prior thereto if

ordered by the Court, with his books, papers, and accounts and submit to an examination and give testimony as to all matters tending to establish solvency or insolvency".

Bankruptcy Act, Sec. 3(d);

11 U.S.C. Sec. 21(d);

Collier on Bankruptcy, Vol. 1, Sec. 3.208(2), p. 456 (14th Ed. 1961).

If the bankrupt refuses to appear with his books, papers, and accounts for examination, then the burden of proving his solvency at the time of the transfer is shifted to him.

Bogen & Trummel v. Protter, 129 Fed. 533, 12 A.B.R. 288 (CA 6 1904);

In re Wilson, 16 F. 2d 177, 9 A.B.R. (N.S.) 63 (C.A. 7 1926);

Collier on Bankruptcy, Vol. I, Sec. 3.208 [2] pp. 456-457 (14th Ed. 1961).

The leading case upon this issue is the *Bogen* case, interpreting the 1898 Bankruptcy Act, whose Section 3(d) was substantially identical to the present one. The bankrupt had denied he was insolvent and had asked for a jury trial upon the issue. The trial judge declined to hold that the bankrupt's failure to appear at the trial with his books, papers, and accounts, shifted the burden of proof to him and directed a verdict in his favor. In reversing the lower court's decision, the Sixth Circuit stated:

> "The law expects a merchant charged with bankruptcy, to support his statements by his books, which speak for themselves. If he submits to examination and produces his books, and his insolvency does not appear, the burden is upon the

petitioners to make the proof, but if he fails to appear for examination, or fails to produce his books, the burden is upon him to prove his solvency. In this case, the testimony showed the sales-book for 1902 was on hand just before the fire. It disappeared after the fire, although it was not burned up. So with the other books. No satisfactory explanation of their disappearance was furnished. It is not sufficient for an alleged bankrupt, when called upon to produce his books, to say, 'I don't know where they are'. It is his business to know where they are. They are the only proper proof of his financial condition. He must not only keep proper books of account, but preserve them, and produce them when called upon. He fails to do so at his peril. The court should have held that, under the circumstances, the burden of proving his solvency rested upon Protter."

The *Wilson* case was also decided under the 1898 Bankruptcy Act. Wilson, the bankrupt, refused to appear at the examination, or testify or produce his books, papers and account. No reason for this refusal is set forth, but it appears that the court felt that any alleged bankrupt had the absolute right to so refuse. Wilson did attempt to prove his solvency through the testimony of his auditor. The court held that this testimony was secondary and therefore not admissible. The court noted that the auditor testified only as to the existence of certain assets as set forth on Wilson's books, and stated

> "There is little else except some evidence as to a few items of his property, but none as to his liabilities, a subject which generally, speaking, is *peculiarly within his own knowledge.*" (emphasis added).

This ruling has great significance when the court remembers the only testimony introduced by the Appellant, was that of Roy Allen, the state court receiver. He admitted he was only able to testify as to Appellant's assets, but not her liabilities, and thus Judge Stephens was free to ignore his testimony. [D.C. Tr. p. 82, lines 2-23.]

The leading decision in this circuit is *Hollister et al. v. Oregon Hardwood Mills,* 15 F. 2d 787, 9 A.B.R. (N.S.) 137 (C.A. 99 1926). The issue on appeal was whether the insolvency of the bankrupt had been established. The court cited Section 3 of the old Bankruptcy Act, to find that the bankrupt's president's testimony was so unsatisfactory as to shift the burden of proof to the bankrupt corporation.

> "The testimony concerning the indebtedness owing and the claims of the original and intervening creditors clearly indicates that no reliable data were furnished by the corporation. The provisions of the act quoted obviously make it the duty of the debtor to render reasonable assistance in the manner indicated by furnishing information concerning his financial condition—being a matter *peculiarly within his knowledge*—in order to determine the question of his solvency or insolvency." (emphasis added).

The statute does not require that the failure to produce books and papers be willful or contumacious in order to throw upon the bankrupt the burden of proving his solvency; the failure to produce, and the absence of a satisfactory explanation is sufficient.

> *Collier on Bankruptcy,* Vol. I, Sec. 3.208 [2] p. 457 (E.D. N.Y. 1932).

In the *Matter of Cayne Construction Co., Inc.,* 58 F. 2d 664, 21 A.B.R. (N.S.) 219 (D.C. N.Y. 1932) the court found that the debtor "failed to produce satisfactory books of account; and thus had the burden of proof on the issue of insolvency shifted to it."

Likewise in *Cummins Grocery Company v. Talley,* 187 Fed. 507, 6 A.B.R. 484 (C.A. 6 1911) stated:

> "The evidence in this case does not indicate that there was any intentional refusal on the part of the respondents to produce papers and accounts relating to the item in question, nor that his failure to do so was contumacious. But the statute does not require his failure be wilful or contumacious in order to throw upon the bankrupt the burden, which is not a drastic one, of proving his solvency. The failure to make such production must be satisfactorily explained."

The Bankrupt Has No Excuse for Her Failure to Produce the Books.

The Sanction of 3(d) is not imposed if the bankrupt is unable to comply as long as they are available to the petitioning creditors. Thus, in the case of *Roberts v. Yegen,* 12 F. 2d 654, 8 A.B.R. (N.S.) 162 (C.A. 9 1926) the court refused to shift the burden of proof where the books and records were in the hands of a state court receiver. The court found that the alleged bankrupt had sufficient excuse in that they had proven they did not have custody of the records, had surrendered them earlier pursuant to a duly made order of the state court, and could not produce them. It is important to note the following statement however:

> "Petitioners were not aggrieved for the record is that they had access to and used the books of the

> Butte and Anaconda banks, and were offered access to the books at Billings and Gardiner; the judge stating that, if desired, he would appoint a special master to take testimony at the outside places. Petitioners, however, did not avail themselves of the offer."

The exception here is clear, Section 3(d) is designed to prove the fact of insolvency by the best possible means—the bankrupt's books and records. If the petitioning creditors can make an examination of the books without the bankrupt producing them, the mere inability of the bankrupt to so produce them does not shift the burden to him.

However, it is the ability to produce the records that determines if the bankrupt has shouldered the burden. Thus is *In re Desha & Willfong,* 30 A.B.R. 130 (Dist. Hawaii 1913) the sheriff had levied upon and seized all of the property of the bankrupt including the books and records. They were held on the island of Hilo, 200 miles away in the custody of a marshal. The court held this did not excuse their production by the alleged bankrupt. In citing Section 3(d) of the 1898 Act the court stated:

> "Congress has deemed it wise to provide this rule because the solvency of an alleged bankrupt is a matter peculiarly within his own knowledge, or almost always within his power to show more easily that it can be shown by anyone else. (citations) Are we, then, to raise an exception to that declared rule of policy merely because, in a case like this, it is as convenient for the petitioning creditors, or for the marshal, or the judge, as it is for the respondent himself, to get the respondent's books

into court? The question answers itself. The statuite having made it the respondent's duty to appear with his books, the burden must remain and is not shifted by the mere consideration of convenience or inconvenience. The contesting respondent Desha could have secured the presence of the books by subpoena d.t. or by other proper order of court, and it was his business to do so."

POINT VI.

The Privilege Against Self-Incrimination Embodied in the Fourth and Fifth Amendment Does Not Exempt the Bankrupt From Assuming the Burden of Proof Upon the Issue of Insolvency.

While a bankrupt may be excused from producing her books and records under a privilege, this is not to say that she escapes the procedural consequences of invoking that privilege. Actually, under all of the cases cited, the bankrupt could simply refuse to produce her books and records by invoking any reason whatsoever. If she does not produce them she simply assumes the burden of proof.

Thus in the recent cases of *In re Shulund,* 210 F. Supp. 195 (D.C. Mont. 1962) the petitioners in an involuntary bankruptcy proceeding sought an order pursuant to either Rule 34, of the Federal Rules of Civil Procedure, or alternatively for an examination pursuant to Section 21(a) of the Bankruptcy Act, (11 U.S.C. Sec. 44a) to compel production and inspection of all books, papers and records of the bankrupt, since the bankrupt had denied the allegation of insolvency and had demanded a jury trial upon the issue. The court denied the motions of the creditors upon the grounds that Section 3(d) of the Bankruptcy Act, precluded

discovery under the Federal Rules of Civil Procedure, and that the only sanction available for refusal to comply with an order to produce their records is to shift the burden of proof to them at the time of trial.

In the *Shulund* decision the Montana District Court reviewed the legislative history of Section 3(d), with Section 21(k). The court reasoned that since one of the stated purposes of the comprehensive revision of the Bankruptcy Act in 1938 was "to improve the procedural sections of the Act . . . in proceedings for discovery" . . . that therefore a relationship existed between Section 21(k) and 3(d). The court quoted House Report No. 1409 to H.R. 8016, 75th Congress, 1st Session p. 21 (1937) . . .

> "Section 21(k): This new subdivision accords with the proposed amendments to Section 3(d) with the present equity practice. It tends to reduce all expenses, speed trials, and the ready production of admitted facts, so as to save the time of court, counsel, and the litigants, particularly in jury trials of contested involuntary proceedings where often a large amount of time is unnecessarily consumed in arriving at what are the actual facts as to admitted assets and liabilities."

This reasoning and the legislative history are important since it shows that Section 3(d) is related to the Federal Rules of Civil Procedure, and is itself a procedural device. Thus while there appears to be no case precisely upon the issue of whether an invocation of the privilege against self-incrimination, excuses an alleged bankrupt from shouldering the burden of proof imposed by Section 3(d), the court may look to other cases deciding whether a claim of privilege avoids the sanctions or procedural consequences of the Federal Rules.

Rule 33 of the Federal Rules of Civil Procedure permit inquiry to the same matters as permitted by Rule 26. Rule 26 permits examination to any matter not privileged. This exclusion of privileged matters is subject to certain limitations. In answer to the rhetorical question, would it make any difference that the privilege was claimed in connection with an affirmative defense? Professor James W. Moore, author of Moore's Federal Practice, Vol. 4, Chap. 26, Sec. 26.22 (5) pp. 1295-1296, says Yes. He believes under such a circumstance the party has waived the privilege, although the party did not intend to waive it.

This theory has been followed by Judge Herlands in *Independent Prod. Corp. v. Loew's Inc.,* 25 F.R. Serv. 26b, 31, Case 2, 22 F.R.D. 266, 276-277 (S.D. N.Y. 1958).

Further on the related issue of the physician patient privilege, Judge Bryan in *Autry v. United States,* 4 F.R. Serv. 2d, (33.334.) Case 1, 27 F.R.D. 399 (S.D. N.Y. 1961).

> "The nature of this action for malpractice is such that the plaintiff cannot possibly try it without waiving his statutory privilege, if he has not done so already. If the plaintiff goes to trial without waiving his privilege the defendant would undoubtedly have the right to apply for and obtain a suspension of the trial to enable the defendant to go into the subject matter which plaintiff has claimed to be privileged and which is material and necessary in its defense.
>
> . . . .
>
> Interrogatories addressed to parties under Rule 33 of the Federal Rules of Civil Procedure may relate

to any matter not privileged which is relevant to the subject matter involved in the pending action. See Rule 26(b). But this does not mean that plaintiff can take advantage of the physician-patient privilege to prevent defendant from inquiring in pretrial proceedings as to relevant and material matters necessary to the defense. If such matters were deferred to the trial the almost inevitable result would be an interruption of the trial when the privilege had been waived by the plaintiff so as to permit the defendant to prepare its defense. In all likelihood a suspension of the trial would be impractical and it would be necessary to declare a mistrial.

Whether the rule as to privilege be governed by state or federal law the plaintiff may not continue his action and at the same time deny to defendant the right to avail itself of the pretrial procedures necessary to prepare its defense."

It is important to note that the Federal Rules specifically excluded all matters claimed privileged, whereas, no such exception is found in Section 3(d) of the Bankruptcy Act. Yet the courts have still refused to allow a claim of privilege, to avoid the procedural consequence of the burden of proof.

An Order Denying a Motion for a Turn Over of the Alleged Bankrupt's Books, Papers, and Documents Does Not Exempt Her From the Procedural Sanction of Section 3(d).

The order of Judge Pierson Hall denies the motion of Irving I. Bass, Mrs. Faucher's Federal Bankruptcy Receiver, to compel a turn over of the books, papers and records. Appellees submit that this order was in

error but the issue now appears moot. But has never been any order entered excusing Mrs. Faucher from permitting her petitioning creditors from examining her books.

The motion brought by Irving I. Bass, was based upon the order of the Federal Bankruptcy Court authorizing and instructing him to take custody and possession of *all* of the property of Mrs. Faucher, including her books, papers and records. Authority for this motion [R 5] for an order that such books and records must be turned over to the Receiver's custody is the case of *In re Fuller & McGee,* 262 U.S. 91, 1 A.B.R. (N.S.) 1, 32 S. Ct. 496, 67 L. Ed. 881 (1923) in which an alleged bankrupt resisted a turn over order for his records upon the grounds that they might tend to incriminate him. In denying him that privilege the court stated:

> "A man who becomes bankrupt, or who is brought into a bankruptcy court, has no right to delay the legal transfer of the possession and title of any of his property to the officers appointed by law, for its custody, or for its disposition, on the grounds that a transfer of such property will carry with it incriminating evidence against him. His property and its possession pass from him by operation and due proceedings of law, and when control or possession have passed from him he has no constitutional rights to prevent its use for any legitimate purpose. His privilege secured to him by the Fourth and Fifth Amendments of the Constitution, is that of refusing himself to produce as incriminating evidence against him anything which he owns or has in his possession and control; this privilege is respect to what was his in his

custody ceases on a transfer of the control and possession which takes place by legal proceedings and in pursuance of the rights of others, even though such transfer may bring the property into the ownership or control of one property subject to a Subpoena Duces Tecum."

Further, in the case of *Dier v. Banton,* 262 U.S. 147, 1 A.B.R. (N.S.) 602, 67 L. Ed. 915, 43 S. Ct. 533 (1922).

Judge Hand's action was based on the ruling of this court in *Johnson v. United States* (citation). He quoted the language used in the Johnson Case. "A party is privileged from producing the evidence, but not from its production". He alluded to the circumstance that in the Johnson Case, there were both title and possession in the trustee, whereas in this case the books and papers were in the hands of the receiver, who had no title, but that he said, made no difference. We agree with this view, and held that the right of the alleged bankrupt to protest against the use of his books and papers relating to his business as evidence against him ceases as soon as his possession and control over them pass from him by the order directing their delivery into the hands of the receiver and into the custody of the court. This change of possession and control is for the purpose of properly carrying on the investigation into the affairs of the alleged bankrupt, and the preservation of his assets pending such investigation, the adjudication of bankruptcy *vel non,* and if the bankruptcy will not be sustained, and in that case the alleged bankrupt will be entitled to a return of his property, including

his books and papers and when they are returned he may refuse to produce them and stand on his constitutional rights. But while they are, in the due course of the bankruptcy proceedings, taken out of his possession and control, his immunity from producing them, secured him under the Fourth and Fifth Amendments, does not inure to his protection. He has lost any right to object to their use as evidence because, not for the purpose of evidence, but in the due investigation of his alleged bankruptcy and the preservation of his estate pending such investigation, the control and possession of his books and papers relating to his business were lawfully taken from him.

It is pressed upon us that the bankrupt may prevent the use of such books and papers taken over by a receiver in the bankruptcy proceedings for evidence in a criminal case in the state court by resisting surrender and protesting against their use for such a purpose at the time the receiver took possession. But we think the alleged bankrupt has no such right. We so held in the Matter of *Fuller* decided April 30, 1923 (citation) in which it was sought to attach conditions of this kind to the turning over of the books and papers of a bankrupt to the trustee in bankruptcy. We are of opinion that the same principle must apply to the delivery of the books and papers relating in the estate into the custody of the receiver of the bankruptcy court.

Counsel still believes that Judge Hall was in error in implicitly overruling the two Supreme Court cases, but could not, of course, appeal from his interlocutory order.

Appellees Established Appellant's Insolvency by Direct Testimony.

In re Eastern Supply Co., 197 F. Supp. 359 (W.D. Pa. 1961) is the mirror image of our case at hand. There, as here, an involuntary petition in bankruptcy was filed alleging the fifth act of bankruptcy, *i.e.* the appointment of a State court receiver while insolvent. There, as here, the alleged bankrupt denied insolvency and demanded a jury trial. At the trial before a Referee sitting with a jury the petitioning creditors offered testimony to show that they had demanded payment upon their debts which was refused, and read into the record, depositions of a collection agency, that had unsuccessfully attempted to collect from the alleged bankrupt. At the end of the petitioning creditors' case, the alleged bankrupt moved for a directed verdict which was refused. The alleged bankrupt offered no defense and the court adjudicated the debtor as a bankrupt.

In sustaining the decision of the referee the court held that insolvency in the equity sense, *i.e.* inability to pay one's debts as they mature, could be proven by inference, citing *In re Wilson,* 16 F. 2d 177 (C.A. 6 1926). The appellate court also pointed out that the alleged bankrupt, had not kept its books up to date, and had not met the duty of producing informative testimony concerning its financial condition, imposed by Section 3(d) of the Bankruptcy Act. The court stated:

> "We believe that the unexplained failure of the partnership and the individual partners to maintain and produce at tbe trial *adequate* books and accounts, or informative testimony, from which an accurate determination of the financial condition of the partnership, as of March 24, 1958,

could be made; shifted to the partnership the burden of proving that the partnership had sufficient money available to pay, as of that date, the partnership debts as they matured, and created a presumption of insolvency in the equity sense which in the absence of proof to the contrary by the partnership and its partners was sufficient in itself to justify the special verdict. Indeed when the partnership decided not to offer any evidence in its defense, had an appropriate motion been made, the Referee might well have directed a verdict in favor of the petitioning creditors. In any event, there was sufficient evidence to sustain the jurys' verdict."

In the case at hand, the alleged bankrupt's only witness, Roy E. Allen, the state court receiver, testified that Mrs. Faucher had obligated herself to payments upon her obligations in excess of income. [D.C. Tr. p. 76, lines 3-21.]

Miss Rebecca Hazel testified she was not paid any money on the notes held by her and her father after March of 1963. [D.C. Tr. pp. 129-130.]

Mr. John J. Giovannoni testified that he received a $165.00 check upon the obligation owed to he and his wife on or about March 2, 1963, and that after depositing the check it was returned marked "insufficient funds." [D.C. Tr. pp. 133-134.]

Mr. Giovannoni further testified he attempted to contact Mrs. Faucher several times without success; telephoned her house and received no response; drove to her house knocked and received no response; inserted a letter under the door; and after some searching con-

tacted Mr. Faucher, but was never able to contact Mrs. Faucher, and never saw her again until after the institution of these proceedings. [D.C. Tr. pp. 135-138.]

Mr. Giovannoni further testified he never received his $300.00 check during or after the month of March, 1963. [D.C. Tr. pp. 142-143.]

This unrebutted testimony clearly demonstrates that on March 22, 1963, at the time of the appointments of the state court receiver, Mrs. Faucher was unable to pay her debts as they matured, and was thus insolvent for the purposes of this particular act of bankruptcy.

Bankruptcy Act, Sec. 3a (5);

11 U.S.C. Sec. 21a(5).

The foregoing is more evidence upon this issue than that presented by the petitioning creditors in the *Eastern Supply Co.* case (*supra*).

Conclusion.

It is submitted that no error occurred prejudicial to Appellant anywhere in these proceedings. Both the Referee and the U. S. District Judges leaned over backwards to be fair to the alleged bankrupt. She was ably defended in these proceedings from start to finish. From the beginning to the end of the litigation she repeatedly and continuously invoked her privilege against self-incrimination to block all efforts on the part of the petitioning creditors to locate her books and records, or to examine her concerning her assets, and liabilities.

She was ordered into court by subpena on August 16, and 23, 1963 to be examined concerning her books and records.]Ex. 29, S. M. Tr. p. 439.] She admitted she had books and records, but refused to dis-

close their location. At that time the burden shifted. The bankrupt never once, by counsel, written pleading, or otherwise, from that day forward indicated any intention of submitting her books and records to Appellees for examination or offered to testify on the issue of insolvency herself.

The fact that every Judge, Referee, and Special Master continued to offer her such an opportunity, up until the jury trial has been seized upon by her to mean, she had a right to do so, and no precedural sanction could be imposed against her until she did appear and refuse to so testify. This contention has no basis in logic or the law.

As to the findings of fact of the Special Master, these are to be accepted unless clearly erroneous.

General Orders in Bankruptcy No. 47.

Judge Stephens granted a directed verdict to Appellees because the Appellant put on no probative evidence whatsover, and the Appellees put on a *prima facie* case. Since Appellant had the burden of proof on the issue of insolvency, a directed verdict was proper.

Respectfully submitted,

RICHARD M. MONEYMAKER,
Attorney for Appellees.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

R. M. MONEYMAKER